No. 12,811.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

vs.

PAUL W. SAMPSELL, Trustee in Bankruptcy of the Estate of Juvenile Products of Pasadena, a corporation, Bankrupt,

Appellee.

BRIEF FOR THE APPELLEE.

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BRIEF FOR THE APPELLEE.

Statement of Facts.

Appellee has examined the Statement of Facts contained in Appellant's Opening Brief, and finds that it is accurate as far as it goes. However, desiring to assist the Court in obtaining the proper perspective in this matter, Appellee wishes to outline in slightly more detail the course of proceedings which culminate in the appeal now under argument.

These proceedings were initiated by the filing of a Petition under Chapter XI, Sec. 322 of the Bankruptcy Act. On July 24, 1948 a Plan of Arrangement was confirmed by the Referee [R. 25-35]. Essentially, this Plan was to pay past creditors out of the proceeds of future opera-

tion [R. 33-34]. Jurisdiction was retained in the Bankruptcy Court for the period required for the fulfillment of the Plan of Arrangement [Par. 9, R. 34, 37-38]. Owing to business vicissitudes, the debtor was unable to operate at a profit; it was, however, able to keep open its doors for some months despite its deteriorating financial situation. It was during this time that the large obligations for taxes, labor and merchandise were incurred, which the Referee has found should share *pro rata* in a fund insufficient to pay all in full [R. 50-51]. In the end, the Referee terminated the losing struggles of the debtor and adjudicated it a bankrupt on December 13, 1948.

Immediately upon adjudication Paul W. Sampsell was appointed Trustee [R. 63] by Order of Court and directed to liquidate the assets of the bankrupt estate. The Trustee, Paul W. Sampsell, received, as reflected by his First Report and Account, the following assets: merchandise and equipment inventoried at $18,058.50 and appraised at $4,650.00 [R. 63]; real property appraised at $36,000.00 and sold for $33,000.00 to the City of Pasadena [R. 64]; and cash totaling $1,105.90 [R. 66]. (Be it noted, that the record indicates [R. 66] that this total of $1,105.90 was composed of $974.67 as "balance from fire losses" and $131.23 as "receipts from sales.") The record does not disclose the receipt of any funds earmarked for taxes of any kind.

After all the assets of the bankrupt estate had been liquidated by the Trustee, the total on hand was insufficient to pay in full all claims arising out of the opera-

tions of the debtor after confirmation of the Plan of Arrangement and before adjudication. Having been informed that Appellant insisted on payment in full of its Chapter XI claim ahead of all other Chapter XI claims, the Appellee filed with the Referee his Petition for Order to Show Cause and for an Order to Restore Order to Show Cause to Calendar [R. 41-44] on which an Order to Show Cause was duly made demanding the presence of the Appellant to try out his asserted claim [R. 44-45].

Before the Referee, and before the District Judge Appellant asserted its right to payment in full before other Chapter XI creditors on two theories: a right to priority of payment under the provisions of the Bankruptcy Act; and a right by a virtue of a trust or equitable lien impressed on all the assets of the bankrupt estate. The first of these two contentions was rejected by both the Referee and the District Judge on the strength of the rule laid down in *Vogel v. Mohawk Electric Sales Co.*, 126 F. 2d 759 (C A. 2d). (It is significant that this contention is not at all urged in Appellant's brief here.) Likewise, both the Referee and the District Judge have rejected the lien or trust claimed by the Appellant; it is to this latter point that Appellant's Opening Brief is entirely directed, and to which Appellee's Brief in answer shall be oriented.

A final fact in this record should be recognized. At the direction of the Court, the Trustee has liquidated all assets of this bankrupt estate in the manner set out in the Trustee's First Report and Account [R. 63-64]. In the process of this liquidation the Trustee expended consider-

able sums [R. 66-70], and became responsible for court costs, costs of and fees to Trustee and his counsel. These have been paid out of the proceeds of this estate. In the light of *Vogel v. Mohawk Electric Sales Co.*, the Appellee cannot see any possible objection to the payment of such expenses before payments to any Chapter XI creditors. It is true that in the instant appeal there are sufficient funds in the hands of the Trustee to pay all such expenses of administration as well as Appellant's claim in full. However, if the contention of Appellant is upheld and carried to its logical conclusion, the result would be to turn all the assets over to Appellant until the trust asserted was satisfied, leaving the Bankruptcy Court powerless to liquidate the assets and pay the costs incident thereto. Appellee does not understand Appellant to be asserting a right to the payment of Chapter XI tax claims before the general expenses of liquidation and administration of the Bankrupt's estate; and it is on this understanding and basis that Appellee submits his brief.

Questions Involved.

I. Can a trust fund in favor of the Appellant herein under section 3661 of the Internal Revenue Code be traced into the fund presently in the hands of the Appellee?

II. Can all funds presently in the hands of the Appellee, without regard to their source, be impressed with a trust or equitable lien in favor of the Appellant herein?

ARGUMENT.

I.

No Trust Fund Belonging to the Appellant Can Be Traced into the Fund Presently in the Hands of the Appellee.

As a point of departure, Appellee takes the law as established that where trust funds have been misapplied, commingled or otherwise improperly dealt with, the *cestui,* to enforce his rights to the proceeds of the trust, must be able to follow the trust property into its new guise, see *Restatement of Trusts,* Section 202; *Restatement of Restitution,* Section 202 *et seq.*; *People v. California Safe Deposit etc. Company,* 175 Cal. 756; *In re Frank,* 25 Fed. Supp. 1005 (D. C., S. D. N. Y.). The rule is succinctly stated in Corpus Juris, Trusts, Section 889.

> "The right to follow trust property, in equity being based on the theory that a right of property still exists in the *cestui que trust,* the equitable right of recovery or reclamation generally does not exist or no trust or lien can be enforced, if the trust property cannot be identified, or traced into some specific fund or thing, which is sought to be charged, and into which the original trust property has gone in some form or other."

Before a *cestui* may begin to trace his trust, he must first establish its existence, otherwise he has nothing to follow. Our first problem, thus, is to decide whether or not the Appellant has a trust, the proceeds of which it may follow.

The Appellant relies upon Section 3661 of the Internal Revenue Code for creation of its trust rights. The pertinent language of Section 3661 is as follows:

> "Whenever any person is required to collect or withhold any internal-revenue tax from another person and to pay such tax over to the United States, the amount of tax *so collected or withheld shall be held to be a special fund in trust for the United States."* (Emphasis supplied.)

Appellee urges that even the most cursory inspection of Section 3661 indicates that before the trust provided by this statute can arise there must first be a tax "collected or withheld"—as the above emphasized language of the statute indicates.

The extensive background of Section 3661, and its interpretation, cited at length by the Appellant only serves to emphasize this important qualification of the trust rights conferred by Section 3661. The Senate Committee Report in connection with the original enactment of Section 3661 is as follows (S. Rep. No. 558, 73d Cong. 2d Sess., p. 53 (1939-1 Cum. Bull. (Part 2), 586, 626)):

> "Existing law provides with respect to a number of taxes that the amount of the tax shall be collected or withheld from the person primarily liable by another person, who is required to return and pay to the Government the amount of the taxes so collected or withheld by him. * * * Under existing law the liability of the person collecting and withholding the taxes to pay over the amount is merely a debt, and he can not be treated as a trustee or proceeded against by distraint. Section 606 of the bill as reported impresses the

> amount of taxes *withheld or collected with a trust* and makes applicable for the enforcement of the Government's claim the administrative provisions for assessment and collection of taxes." (Emphasis supplied.)

The Conference Report on the same bill reflects the same qualification on the rights being conferred. (H. Conference Rep. No. 1385, 73d Cong., 2d Sess., p. 32 (1939-1 Cum. Bull. (Part 2) 627, 639-640)):

> "This amendment impresses *taxes collected or withheld with a trust* in favor of the United States and makes applicable for the enforcement of the Government's claim the administrative provisions applying to the assessment, collection, and payment of taxes." (Emphasis supplied.)

Treasury Regulations recognize this qualification on the rights conferred by Section 3661. See Regulations 116, Section 405.301 as follows:

> "The amount of *any tax withheld and collected* by the employer is a special fund in trust for the United States." (Emphasis supplied.)

See also Regulations 106, Section 402.304:

> "Any employees' *tax collected* by or on behalf of an employer is a special fund in trust for the United States. * * *" (Emphasis supplied.)

Now, the Referee has found [R. 49]:

> "* * * the court further finds that when wages were paid by this Bankrupt Corporation during its operation under Chapter XI, the requirements that withholding taxes be withheld and placed in a trust fund were ignored, that is to say, the net amount—*i. e.,* the gross amount of wages, less the amount of

> withholding tax—was at all times paid; the Court further finds that during the said operation under Chapter XI this Bankrupt Corporation at no time had the funds to create or did it create a separate trust fund composed of that portion of the wages withheld for the payment of the withholding taxes."

It seems to the Appellee that this Finding, which, be it noted, is not challenged anywhere in the Appellant's Opening Brief, effectively concludes the question of any direct trust rights in the Appellant under Section 3661 of the Internal Revenue Code. In order for the trust fund created by Section 3661 to come into existence the taxes must actually be collected or withheld. It has been specifically found by the Referee in this case that no such taxes were ever collected or withheld. Here was a debtor operating under Chapter XI on the ragged edge of financial collapse. When pay-rolls fell due the net amounts necessary were wrung from the business and the net amount only was paid to employees. The debtor never had in his hands at any time the difference between the net amount of wages paid and the gross amount of wages, that is, the withheld taxes.

Assuming for the purposes of argument that the withheld taxes were actually withheld and that therefore Section 3661 of the Internal Revenue Code did actually raise a trust in favor of the Appellant, the problem of tracing the trust funds into their metamorphoses still confronts the government. This record does not disclose that any of the sums so assumed to have been withheld were ever incorporated into any of the assets which came to the hands of the Trustee in Bankruptcy. The Trustee received $1,-105.90 in cash funds from H. B. Kelley, the disbursing agent [R. 66]; of this $974.67 was a "balance from fire

losses" [R. 66] and $131.23 was a "receipts from sales" [R. 66]. The mere designation of these funds precludes the conclusion that any money assumed to have been impressed by Section 3661 of the Internal Revenue Code with a trust was commingled therewith. For the rest, the record reflects that the Trustee received real estate [R. 64], merchandise, supplies, machinery and office furniture and fixtures [R. 63]. The Appellee repeats that in none of these assets has the Appellant been able to demonstrate the investment or the inclusion of so much as one penny of any taxes assumed to have been withheld.

With a deviousness which somewhat confounds the Appellee, and in the face of a record which contains no evidence to support it, Appellant contends that the assumed trust funds can here be traced into the assets in the hands of the Trustee. First of all Appellant argues that the amount withheld never became part of the bankrupt estate. There can be no question that *if* taxes were actually withheld and *if* this sum could be identified it would belong to the Government and should be turned over to it forthwith. Indeed, that is precisely the situation in the case on which the Government rests in support of its contention, namely, *In re Goldberger, Inc.*, 32 Fed. Supp. 615 (E. D. N. Y.). In this case the bankrupt, operating under Section 77b of the Bankruptcy Act before that Act was amended in 1938, collected $162.76 in city sales taxes. Apparently the sales tax had been held separate and was a fund existing in the hands of the Trustee at the time of appeal. The Trustee contested the demand of the City of New York that he pay it over, and contended that the City should be treated in the same manner as any other tax creditor. The *Goldberger* case is not apposite to this appeal. In that case the money had been withheld and apparently was in

existence as a separate fund; here, aside from the fact that the Finding of the Trial Court indicates no monies were ever withheld, these monies do not presently exist, were not turned over to the Trustee in a separate fund. Therefore the *Goldberger* case is of no assistance in determining the rights of the Appellant in the instant appeal.

Next, in support of this contention Appellant turns to the case of *Garrison v. Edward Brown & Sons,* 25 Cal. 2d 473, and cites it to the following effect:

> "It is settled both as to express trusts and trusts created by operation of law that an ascertainable interest in the bank account of the trustee in which funds of the trustee and the beneficiary are deposited constitutes an asset definite enough to be the subject matter of the trust."

Appellee concedes this is a proper statement of the law on this point. Consider, however, the use to which Appellant puts the rule enunciated. The Appellant concludes from this case as follows (p. 31):

> "The same rule, which the cited case applies to an ascertainable interest in the bank account of the trustee, should apply equally to an ascertainable interest in other estate assets. The assets, which are in the hands of the Court, *have been directly added to and benefited by an amount of money withheld by the debtor in possession from the wages of employees."* (Emphasis supplied.)

The italicized portion of the Appellant's argument begs the question involved in this appeal because it assumes the very fact that Appellant is attempting to demonstrate—that is, that the funds assumed to be withheld were incorporated in or became a portion of the assets which were later turned over to the Trustee. There is not a bit of evidence in this record to sustain such a conclusion.

Appellant attempts to cast the burden of proof as to this essential tracing of trust property upon the Appellee by citing *Scully v. Pacific State Savings & Loan Company,* 88 F. 2d 384 (C. A. 9) to the effect that:

> "*The cash items being shown to be in the trust fund, the lien must be impressed,* unless Appellant, who has the laboring oar, has shown a dissipation of the trust fund." (Emphasis supplied.)

The italicized portion again illustrates the effort of the Appellant to beg the question here: the *Scully* case proceeds upon the obvious theory that the cash items, in that case deposits made by an agent in a general account, are shown to actually have been trust funds commingled with the general funds of the agent. The very essence of tracing the trust property in this appeal is to demonstrate that the taxes allegedly withheld were incorporated in, and were a portion of the assets which were eventually turned over to the trustee. Appellee can only restate the same point: that there is no evidence anywhere in this record indicating that the taxes withheld became a portion of or were invested in, or were included in any way in the assets which eventually came to the hands of the Trustee.

To summarize the argument so far made by the Appellee, the claim of Appellant to treatment distinct from other creditors whose claims arose after confirmation of the Plan of Arrangement, but before adjudication can not rest upon any trust created by the debtor for the following reasons: (1) No taxes were withheld and therefore the trust raised by Section 3661 of the Internal Revenue Code did not come into existence. (2) Even assuming that there was a trust raised by Section 3661 of the Internal Revenue Code, Appellant has been unable to trace any of such assumed trust funds into assets which came to the Trustee in bankruptcy upon his qualification.

II.

The General Assets of the Bankruptcy Estate Should Not Be Impressed With an Equitable Lien or Trust Unless Trust Funds Can Be Followed Into Them.

Appellant makes as its principal contention "a bankruptcy court, as a court of equity, will require the administration of an estate under its control to proceed in accordance with the congressional mandate and direct, in trust for the United States, the segregation of estate assets sufficient to pay the withholding taxes deducted and the distribution to the United States, as trust beneficiary, of the amount of the trust fund so segregated." Reduced to its simplest terms this contention seeks to impress a trust on the general assets of a bankruptcy estate without regard to whether or not trust funds can be traced thereto.

To support its principal argument Appellant relies mainly upon the case of *City of New York v. Rassner,* 127 F. 2d 703 (C. A. 2d). In this case, New Bedford Rest, Inc., filed a petition for an arrangement under Chapter XI of the Bankruptcy Act, 11 U. S. C. A., Sec. 701 *et seq.,* on January 19, 1939. The debtor was permitted to remain in possession and to operate the business until November 14, 1939, at which time it was adjudicated a bankrupt. In the interim, and during the course of the operation of its business, the debtor in possession collected New York City sales taxes. The New York law constituted the vendor a "trustee" when collecting such sales taxes from vendees. After adjudication, Rassner was appointed Trustee and received $7.50 in cash as the only assets turned over to him by the debtor. Thereafter, certain chattel mortgages were invalidated and the property so obtained liquidated so that the estate realized $4,272.95

therefrom. The City of New York claimed that it was entitled to payment in full out of the proceeds of the funds in the hands of the Trustee for all sales taxes collected by the debtor in possession. The Court of Appeals for the Second Circuit held that the City of New York was entitled to payment in full, that an equitable lien or trust would be impressed on all assets, regardless of their source, to provide such payment.

Appellants asserts that the *Rassner* case is "substantially on all fours with the instant case." With this conclusion Appellee cannot agree: a careful study of the *Rassner* case indicates to the Appellee that it can be distinguished on a number of grounds.

First of all, the opinion in the *Rassner* case indicates very clearly that the sales tax had actually been collected by the vendor-debtor in possession. At page 705 of 127 F. 2d the Court says:

> "*Since the records of the debtor disclose that the tax was collected,* the city may rest on its status as a beneficiary of a trust." (Emphasis supplied.)

And again in discussing a number of cited cases which will be examined at more length later on in Appellee's Brief, at page 706 of 127 F. 2d the Court says:

> "It is hardly an answer to these cases to say that in them the general estate has been augmented by the proceeds; for that happened no more or no less in this case unless we assume, without evidence and contrary to all presumption, that here the debtor made off with the funds."

From these statements Appellee contends that it is apparent that in deciding the *Rassner* case the Court proceeded upon an assumption that the sales tax had been collected

and that at one time there was actually a trust fund composed of the funds so collected in existence. As argued hereinbefore, and repeated here, the position of Appellee is that there has never been any trust fund in existence in this instant appeal. Section 3661 of the Internal Revenue Code provides for a trust fund of "the amount of tax so collected or withheld." The record in this case, and the Finding of the Referee, indicates very clearly that there were never any taxes withheld, and therefore under Section 3661 of the Internal Revenue Code, and by its specific language, the instant case differs from the *Rassner* case because there was never any trust fund in existence to be improperly dissipated by the debtor in possession.

The *Rassner* case depends upon a number of other cases which have the same distinction as Appellee has made hereinabove to the *Rassner* case: they are all cases in which the trust has actually at one time been in existence. In the case of *Standard Oil Company of Kentucky v. Hawkins,* 74 Fed. 395 (C. A. 7) the problem was raised by the payment of money under a mistake of law. On July 24, 1893, the Indianapolis National Bank closed its doors and never reopened them. Apparently it was hopelessly insolvent at that time. Shortly before the conclusion of business on July 24th the Standard Oil Company deposited $1746.71 in the bank. Thereafter Hawkins became Receiver of the National Bank through appointment by the Comptroller of Currency. Appellant filed a claim with the Receiver embodying the $1,746.71 paid on July 24, and received a 25% dividend thereon, which was refused. It later developed that the Standard Oil Company might be able to recover the deposit made on July 24. Among other contentions made was that the Standard Oil Company could not recover because of inability to trace its funds.

At page 399 of 74 Fed. the Court makes the following ruling on this contention:

> "In such case equity should compel restitution of that which has been diverted, and, being unable to lay hold of the specific moneys improperly received, will seek to make restitution out of the assets which remain."

It is very apparent in this case that at one time the Receiver, or the National Bank had actually in its possession the funds which belonged to the Standard Oil Company. Another case similar to this is that of *Hood v. Hardesty,* 94 F. 2d 26 (C. A. 4th). The Receiver of a national bank, the plaintiff here, in accordance with local law, deposited with the Receiver of the State Bank, defendant here, certain bonds to secure deposits made by the defendant with the plaintiff. Thereafter the plaintiff became insolvent and the pledged bonds were sold with the approval of the plaintiff and the proceeds of the sale paid over to the defendant. Now plaintiff seeks to recover the payments claiming that the funds so paid over were a trust fund. At page 29 of 94 F. 2d the Court makes this ruling concerning following trust funds:

> "On the third question, no case is presented for application of the doctrine of tracing trust funds. Defendant in his official capacity has received, from the proceeds of the bonds improperly pledged, funds to which he is not legally entitled. These may have been disbursed to general creditors; but he now has on hand other funds from which restitution can be made without injustice to any one. It is well settled that in such case a court of equity will direct restitution."

The *Rassner* case also relies upon *Shipe v. Consumers' Service Co.,* 28 F. 2d 53 (D. C. N. D. Ind.). In that case the bankruptcy estate consisted of filling stations operated by the Receiver in bankruptcy. During the operation the Receiver collected $156.13 in "license fee" at the rate of three cents per gallon on all gasoline sold. This money was collected under a statute of the State of Indiana which provided that the money should be collected and that any one so collecting the money should account to the State therefor. The District Court held that the Receiver was a dealer in gasoline, that when he collected the money he became a fiduciary holding it for the benefit of the State of Indiana. In response to the contention that the State could not recover the funds because they could not be traced, the Court at page 54 of 28 F. 2d ruled as follows:

> "* * * the fact that the identical money cannot be traced, that there are no 'ear-marks' to enable identification, is not material. The 'ear-mark' rule has long since been modified, to permit the payment out of any funds in the hands of the receiver."

In the case of *In re Kenney & Greenwood, Inc.,* 23 F. 2d 681 (D. C. Me.). The claimant had deposited with the bankrupt, prior to bankruptcy, certain securities. The trustee in bankruptcy took these securities over and sold them for $917.77. At one time during the course of the trustee's administration he paid out under Order of Court more money than he received from the sale of the bonds. The Court ruled in response to the contention that the trust funds could not be traced that restitution would not need to be made out of the particular proceeds of the bonds, but could be made out of the general assets of the estate. Finally in the case of *Ex parte Simmons,* 16 Q. B. Div. 308, a case was presented where moneys had been paid to

a bankruptcy trustee in England under a mistake of law. Thereafter the Trustee had distributed the funds to creditors. The Court held that the money which had come into the hands of the Receiver, later the Trustee in bankruptcy, must be returned as it would be an unjust enrichment to creditors to permit them to retain that to which the estate was not entitled. The Court determined that the repayment could be out of any assets in the hands of the bankruptcy trustee and need not depend upon tracing of trust funds.

In each of the cases cited at length above, assets were brought in to the estate and a trust therefor at one time created. In the instant appeal, however, no funds were brought into the estate, no trust fund was ever created under Section 3661 of the Internal Revenue Code. Thus, the reasoning on which all of the above cases, leading to the *Rassner* case, depended—unjust benefit to creditors—is not present in the instant appeal. Here, instead, it is proposed to deprive Chapter XI creditors still further because of an improper act by the debtor in possession from which they do not benefit and over which they had no control. Appellee feels that to do this in the name of equity is to lend that venerable institution to the perpetration of a gross injustice.

Another ground on which the *Rassner* case may be distinguished in the opinion of Appellee depends upon the course taken by the proceeding in that case as compared with the instant appeal. The Appellee submits that they are not the same. A careful reading of the opinion in the

Rassner case indicates that the petition in Chapter XI was filed January 19, 1939, and the court states at pages 704 and 705 of 127 F. 2d:

> "* * * the debtor was permitted to remain in possession and to conduct the business until November 14, 1939, when it was adjudicated a bankrupt."

The opinion is silent as to any confirmation of a Plan of Arrangement. In the absence of such statement Appellee believes that we are justified in assuming that between January 19, 1939, and November 14, 1939, this business was operated by a debtor in possession who was, simultaneously, attempting to perfect a Plan of Arrangement which would meet with the acceptance of his creditors. Apparently the debtor in possession was not successful in coming forth with such a plan and adjudication followed. This is not the factual situation on the instant appeal. On April 6, 1948, the Juvenile Products of Pasadena, the debtor, filed a Chapter XI Petition under Section 322 of the Bankruptcy Act. The debtor was permitted to remain in possession. On July 24, 1948, an Order was made confirming a proposed Plan of Arrangement under Chapter XI. On December 13, 1948, the debtor, having failed to live up to its Plan of Arrangement, was adjudicated a bankrupt, and the Referee entered an Order directing that bankruptcy be proceeded with in the usual manner. The controversy here has to do with taxes incurred between July 24, 1948, and December 13, 1948.

Even the most cursory reading of the opinion by the Court in the *Rassner* case indicates that behind it lies a sense of shock that a Federal Court could have been so lax as to permit its agent to misapply trust funds. The theory of the *Rassner* opinion seems to be that where

Court appointed fiduciaries have misappropriated a trust fund and misapplied the proceeds thereof, all assets of the estate should be charged, in equity, with an equitable lien or trust to protect the *cestui*. At page 706 of 127 F. 2d the Court rules as follows:

> "Protection of a beneficiary of a trust whose funds had been misappropriated is a proper part of equitable administration."

Such a theory proceeds upon the close interrelationship of the Court with its appointed agent who has misapplied trust funds. Where the debtor is in that misty period when it is attempting to perfect a Plan of Arrangement, and it is as yet undetermined as to whether the plan will be confirmed, the debtor adjudicated, or the proceedings dismissed entirely, as a practical matter the bankruptcy court must, of necessity, be very close to the day to day operations of the debtor. This is necessary so as to protect the interest of various creditors. Once, however, a plan of Arrangement is confirmed a distinct alteration in the complexion of the proceedings takes place. The debtor is, at least in theory, on his way out of the woods, although the timber may still be thick about him. The rights of his creditors have been materially altered by the confirmation of the Plan of Arrangement; and his duties to them fixed in a new mold. Thus, as a practical matter, the supervision by the bankruptcy court of a debtor operating under a confirmed Plan of Arrangements is not as close as the supervision of a Court during the period antedating the confirmation of such a plan. To grasp this essential distinction, is to perceive the essence of the clear difference Appellee sees between the *Rassner* case and this instant appeal. What basis in equity there is for attaching an equitable lien or trust on assets into which no trust

funds can be traced must rest on the participation of the court, through its agents, in an unmoral misapplication of funds not actually the property of the bankruptcy administration. When a Plan of Arrangement has been confirmed, the relation of the Court to the debtor in possession becomes tenuous indeed; the only concern of the Court then, is to see that the terms of the Plan are faithfully and fully carried out. Appellee submits that in such a situation the intimate relationship which is the theoretical basis of the *Rassner* case is gone and its harsh rule should not be applied.

Appellee is not unmindful of the fact that in the Plan of Arrangement as confirmed in this case jurisdiction over the debtor was retained by the bankruptcy court. A reading of the entire order confirming the Plan of Arrangement, with particular attention to the portion which provides for retention of jurisdiction, indicates that implicit throughout that Order is the intention of the Court that the debtor under the confirmed Plan should continue to operate its business, and that jurisdiction would be retained only so that the Court could make sure that the debtor complied with the terms of the Plan of Arrangement. Under the Order retaining jurisdiction the Court had no intention of becoming a day by day supervisor of the operations of the debtor, such as would have been necessary to assure that all taxes were being paid, that all current obligations were being met, etc. The situation was that the debtor was operating under his plan of Arrangement, attempting to make sufficient profit to pay off old creditors; the court had merely retained jurisdiction to see that those payments were made. Appellee submits that it is unfair to fasten upon all the assets of this Estate a lien as provided in the *Rassner* case simply because the

Court endeavored to see that the Plan of Arrangement which it had approved was fairly and fully carried out.

In the *Rassner* case the Court makes clear that one of the fundamental reasons behind its decision was the inability of the City of New York to secure satisfaction from the Court or any of its agents for the failure to hold separate the sales taxes collected. The Court in the *Rassner* case at page 706 of 127 F. 2d says:

> "The City could hardly seek fine or imprisonment of the debtor or its officers for failure to segregate funds—assuming the penal provisions, Administrative Code, c. 41, Tit. N, Sec. 41-17.0 as amended by Local Laws 1940, p. 362, go that far—because the status of the debtor as under court control would be a defense."

The disbursing agent H. B. Kelley, is in the instant case under bond and his bond is not exonerated under the Bankruptcy Act until July, 1951. Section 50 of the Bankruptcy Act (U. S. C., Tit. 11, Chapter 5, Sec. 78) provides as follows:

> "Proceedings upon receiver's or trustee's bonds shall not be brought subsequent to two years after their respective discharges."

If the law has been in any way violated the proper remedy for Appellant is to proceed against Kelley on his bond. Appellee submits that in view of this other possible remedy it is inequitable to attempt to fix upon all the assets of this estate an equitable lien or trust in favor of the appellant. To establish such equitable rights is to deprive other creditors of payment, and yet permit the disbursing agent who was bonded for faithful performance of his duty to escape liability.

One final point should be raised in connection with the *Rassner* decision. At page 707 of 127 F. 2d the Court states:

> "The city agrees that the trustee may receive the value of his services in creating the fund, and we think that a reasonable view."

As indicated hereinbefore, this argument by the Appellee proceeds on the assumption that the Appellant does not contest the right of the bankruptcy court to direct payment of the expenses of liquidation ahead of any payment to the Appellant, even if the trust asserted by the Appellant were to be upheld. To rule so would be to cripple bankruptcy administration by denying to it the right to pay for the conduct of the liquidation. To adopt so extreme a rule would be disastrous to cases now pending which present the same problem as this instant appeal only in a more aggrevated form.

Conclusion.

For reasons set out at length hereinbefore, Appellant should be denied payment before other creditors whose claims arose after the confirmation of the Plan of Arrangement and before adjudication; rather the Appellant should share *pro rata* with such creditors. The Order of the District Court to this effect is correct and should be sustained.

Respectfully submitted,

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